



Andy MacFaul
Head of Government Affairs
Ofgem
9 Millbank
London
SW1P 3GE

Direct lines:
Tel: 020 7257 0132
Fax: 020 7257 0101
Tanya.Morrison@shell.com

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Dear Andy

Ofgem's three year strategy 2005-8

I refer to the letter from Sir John Mogg seeking views on the key challenges faced by the gas and electricity industries in the short to medium term; the action the Authority should consider taking to respond to these challenges and what priorities should be chosen. Shell Gas Direct is a licensed shipper and supplier to non-domestic gas customers; our comments therefore focus on gas industry issues.

We note that in his letter Sir John refers to the RPI-X regime that Ofgem intends to place itself under. We had hoped that the X would be announced and implemented by now. In line with our comments below, we consider that an initial P_o cut would be appropriate to bring Ofgem into line with cost pressures faced by the price controlled and competitive industry participants it regulates.

Priorities and pace of industry change

The key challenge that we face as an industry is the level and pace of change. While some is driven by external events and agencies, over the past year, Ofgem has increased the level of its involvement in, and initiatives to change, the gas industry and its structures. RGMA has been implemented while a high workload commenced with the proposed DN Sale (and associated additional items Ofgem has added into this project). We are not aware of any effort by Ofgem to decrease or reprioritise workload from other sections while this work has been taken forward. Indeed, Ofgem staff appear unaware that there are overlapping requests for data, consultations, and implementation periods and the impact these have.

In line with many responses to last year's consultation on Ofgem's strategy, we continue to consider that Ofgem is too large given that there are competitive supply markets and well established approaches to regulating the natural monopolies. The indirect costs of Ofgem are significantly higher than direct costs and can lead to inefficient allocation of industry resources.

Ofgem is able to establish and/or staff an ever-increasing number of workgroups. We do not consider discussions in workgroups can be, or should be, considered substitutes for formal consultation and it must be accepted that any views reached by workgroup participants may not be implemented once the views of the wider industry are taken into account following proper consultation. As it is not possible for all in the industry to

attend all of these groups, we recommend that more effort is made so that Ofgem staff understand the activities in each other's work areas and/or workgroups so that they can comment on how different strands of work are consistent and relate. This would aid transparency of Ofgem's work. Ofgem should also establish regular events for the industry, perhaps once per quarter, where overviews of progress in the various areas of work can be presented at a single event.

We are concerned about the lack of clarity regarding decisions to establish new workgroups. Workgroups have been started despite industry views that there was no pressing issue to resolve and in the absence of criteria that Ofgem has consulted upon. Ofgem and NGT appear to agree to start workgroups absent industry participants' input. Ofgem needs to be clearer about the decision making process to initiate new areas of work when they have not been previously flagged in the corporate plan. When it is necessary to start new areas of work, Ofgem should explain what it will now be giving lower priority.

The Authority should focus on providing as much stability to the competitive market as possible given the extent of change in the current industry environment. This means reducing the pace of change promoted by Ofgem, re-prioritising or delaying work when required, and ensuring that Ofgem has provided full analysis before starting to consider how to implement its solutions. Ofgem should also focus on improving its communications, consultation process and response to representations and putting into action best regulatory practice principles. Ofgem staff should also try to gain a better understanding of the system impacts of the changes they are proposing and the ability of the industry to absorb many over-lapping changes at once. It is clear that Ofgem initiatives are taking industry resources away from competitive activities: this is to the detriment of the consumer.

We welcome Ofgem's recent commitment to extend consultation periods to 6 weeks. We now consider that 8 weeks is more appropriate and longer periods should be considered if there are a number of other Ofgem consultations published within the same time period. Sufficient time must also be given to respond to other requests Ofgem makes of the industry. For example, it is difficult to be fully confident of the results of costing exercises for RIAs given the very short time in which we are expected to put together this information.

Regulation of natural monopolies.

We consider that the RPI-X formulation with regular, eg five-yearly, reviews is a good approach to regulating the revenue of natural monopolies. We see that this approach provides the stability to the competitive market to allow it to take forward investment and service offerings to the benefit of consumers. We have been concerned that Ofgem appears to consider its main task to find new areas of natural monopoly that it can make "contestable". The Authority should ensure that Ofgem makes clearer its underlying philosophy. More analysis and structure to this type of work needs to be provided. We do not consider that there are many areas of contestability remaining and instead consider that the benefits of such projects are now likely to be outweighed by both implementation and on-going costs.

Ofgem's effectiveness

Ofgem now must have regard to the principles of best regulatory practice. While we welcome statements confirming Ofgem's commitment, the task now must be to show that Ofgem is put these principles into action. Ofgem should consider looking at how it measures whether it is efficient and effective. Ofgem should produce regular, eg quarterly, reports on how long it is taking to make decision on code modifications. While we acknowledge that some proposals need detailed consideration, there are too

many cases where Ofgem has taken over 6 months (or over a year) to make decisions on modifications which had already been subject to significant industry discussion with Ofgem staff present. When implementing major projects, Ofgem should establish *ex ante* what success criteria will be and then do *ex post* evaluations using these criteria. To ensure accountability, Ofgem should consider having some evaluations carried out by third parties so that the evaluations can be carried out dispassionately.

Conclusion

Shell Gas Direct welcomes opportunities to work with Ofgem to find solutions to problems in the market. However, this work must be prioritised, be accompanied by robust analysis and take into account the workload that Ofgem places on the industry. We welcome the Authority's undertaking to introduce an RPI-X regime and its commitment to implement the principles of best regulatory practice.

Yours sincerely

Tanya Morrison
Regulatory Affairs Manager